

INSIGHTS

Treasury and the IRS Fuel Taxpayers' Confidence Regarding Section 45Q Credits following Call for Suspension of the Credits

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On May 28, 2020, the Department of Treasury and the Internal Revenue Service (IRS) issued proposed regulations (Proposed Regulations) under Section 45Q of the Internal Revenue Code (Section 45Q) for the capture, utilization and storage of carbon oxide (Section 45Q Credits).

The Proposed Regulations are the latest in a series of guidelines detailing the requirements for claiming Section 45Q Credits, and renewing optimism for investment in the development and operation of carbon capture, utilization and storage projects.

Carbon capture, utilization and storage project developers and investors have indeed welcomed the Proposed Regulations, particularly after the U.S. Treasury Inspector General for Tax Administration (TIGTA) threatened to derail the availability of tax credits for such projects.

Background

On April 15, 2020, in response to a request by Senator Bob Menendez of New Jersey, TIGTA reported discrepancies between the amount of Section 45Q Credits claimed, and the amount of sequestered carbon reported to the Environmental Protection Agency (EPA) pursuant to the Greenhouse Gas Reporting Requirement under subpart RR (Subpart RR). Specifically, the investigation revealed that approximately \$893 million of credits, almost 87 percent of all credits claimed, had been claimed by taxpayers that had not complied with the monitoring, reporting and verification (MRV) requirements of the EPA regarding the sequestration of carbon oxide.

In light of these findings, on April 29, 2020 Senator Menendez requested that, among other things, the IRS “suspend the use of the Section 45Q credit entirely for enhanced oil recovery operations until a full investigation on the past misuse of the credit by this industry can be conducted.”

Industry Reaction

In response, the Carbon Capture Coalition (the Coalition), an alliance that includes energy and technology companies, labor unions, and policy organizations, while expressing its support for the transparency and accountability measures demanded by Senator Menendez, opposed the suspension of the credit on the grounds that it would penalize current projects under development. The Coalition further stressed that the TIGTA findings suggest that the IRS audit

process is working properly and that the way forward is to continue to enforce existing standards.

Standard for Secure Geological Storage and Utilization under the Proposed Regulations

The Proposed Regulations reaffirmed the MRV requirements of the EPA as the standard for secure geological storage. In addition, the Proposed Regulations provided taxpayers with the option to rely on the CSA/ANSI ISO 27916:19 standard (ISO Standard) as an alternative compliance requirement for Class II wells, the latter being subject to third party certification by a qualified independent engineer or geologist.

In doing so, the Treasury and the IRS should draw praise from the oil industry by providing a compliance alternative, which unless otherwise required by law, does not require public reports of the amount of qualified carbon oxide sequestered, whereas Subpart RR does entail the public provision of such data, according to the Proposed Regulations. In addition, the IRS recognized that allowing taxpayers to rely on the ISO Standard may lower their compliance costs, thus leading to more investment and more new projects.

The Way Forward

The Proposed Regulations seem to be signaling an investor-friendly regulatory mindset (particularly when assessed against the backdrop of calls for credit suspensions), and could be used as a weathervane for what lies ahead.

Industry players such as the Coalition may now indeed be emboldened to renew efforts to pursue the more aggressive aspects of their agenda: for example, an important legislative priority for the Coalition is to provide project developers with the option of a cash grant in lieu of a tax credit. We may see the Coalition taking active steps with the legislature in this regard.

It is also possible that a multiyear extension of the Section 45Q Credits will be discussed in the context of another COVID-19 stimulus package, as construction delays caused by the pandemic risk jeopardizing developers' ability to begin construction of their projects by the current deadline of 2023. However, it is unclear whether such an extension will be adopted as the current administration has frequently expressed skepticism of temporary clean energy tax incentives (although an IRS guidance has recently, among other things, extended the continuity safe harbor for both the production tax credit and investment tax credit by a year for renewable energy projects that began construction in 2016 and 2017).

Importantly, the Proposed Regulations have clarified previously uncertain rules regarding tax credit recapture, taxpayer eligibility, and credit transfers. The deadline for comments to the Proposed Regulations has not yet passed (as of the date of this article); however, it would seem that the Proposed Regulations, taken together with prior Section 45Q guidance, have finally provided an adequate framework for developers and investors to move forward with their carbon capture projects.